

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Lowenthal Analyst: Jeani Brent Bill Number: AB 1903
Related Bills: See Legislative History Telephone: 845-3410 Amended Date: 03/16/2000
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Low-Income Housing Credits May Be Transferred, Sold, or Assigned Separately From Federal Credit

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would provide that the state low-income housing tax credit may be transferred, sold, or assigned separately from the federal low-income housing tax credit. This bill would have the effect of allowing taxpayers with a tax liability insufficient to use all their housing credit to benefit from the credit by selling or transferring the excess amount in the current year, rather than carrying it over to later years.

This bill would also make changes to the Insurance Tax Law. These changes do not affect the department and are not discussed in this analysis.

SUMMARY OF AMENDMENT

The March 16, 2000, amendments reflect existing law as changed by the enactment of AB 1626 (Stats. 2000, Ch. 3).

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would apply to taxable and income years beginning on or after January 1, 2000.

LEGISLATIVE HISTORY

AB 1626 (Stats. 2000, Ch. 3) increased the aggregate allocation amount for the low-income housing credit to \$50 million for each calendar year after 1999.

AB 97 (Ch. 893, Stats. 1999) provided that the chapter authorizing the Tax Credit Allocation Committee (the Committee) to allocate the credit would remain in effect as long as the federal low-income housing credit is in effect.

AB 168 (Ch. 9, Stats. 1998) increased the maximum annual allocation amount to \$50 million for calendar years 1998 and 1999 only.

SPECIFIC FINDINGS

Existing federal law allows a credit to an owner of a qualified low-income housing project that is constructed, rehabilitated, or acquired. A state authority created to oversee the process must allocate the credit.

Board Position:

<u> </u> S	<u> </u> NA	<u> </u> NP
<u> </u> SA	<u> </u> O	<u> </u> NAR
<u> </u> N	<u> </u> OUA	<u> </u> X PENDING

Department Director

Date

Alan Hunter for GHG

4/5/00

Under federal law, the low-income housing credit may be transferred to a taxpayer who acquires the low-income housing building for which the credit was allocated, as explained below. However, the credit otherwise cannot be sold transferred or assigned.

If a taxpayer acquires an existing building or interest therein for which a federal credit was allowed to any prior owner before the end of the building's compliance period, the acquiring taxpayer may continue to claim the amount of credit that would have been allowable for that period to the prior owner, provided all the requirements continue to be met. For the year of the transfer, the credit is allocated among the prior and subsequent owners based on the number of days the building or interest was held by each. A credit need not actually have been claimed by a prior owner to allow a subsequent owner to claim the credit; if the building is transferred before the prior owner actually claims the credit but after receiving an allocation or having qualified for an allocation, the credit will be considered allowed to the prior owner. However, the prior owner must actually have received a low-income housing credit allocation for the building from a state housing credit agency before the transfer.

Further, under the federal consolidated return rules, the consolidated tax liability of the group is reduced by the consolidated credit. The consolidated credit basically is the aggregate of the credits, including the low-income housing credit, earned by all members of the group for the consolidated return year. This consolidation, in effect, allows the members of the group to share in the tax benefit of tax credits, including the low-income housing credit.

Existing state law conforms to federal law with some modifications. State law does not allow consolidated returns. For the low income housing credit, however, state law provides similar treatment by allowing a corporation to assign any portion of the low-income housing credit to one or more affiliated corporations, provided the affiliation is 100% ownership.

This bill would provide that the state low-income housing tax credit may be transferred, sold, or assigned separately from the federal low-income tax credit.

Policy Considerations

Generally, tax credits are allowed only to the taxpayer that actually pays or incurs the related expense. Although the low-income housing credit statute specifically permits the credit to be transferred, the transfer is limited only to a purchaser of the property. The state credit may be transferred between affiliated corporations if the affiliation is 100% ownership, but this treatment merely gives the state low-income housing credit the same treatment as that provided under the federal consolidated return rules.

Conversely, this bill would create a state tax law precedent by allowing tax credits to be transferred from the taxpayer who incurred the expenses to **any** other taxpayer (irrespective of whether such transferee is an affiliate). Thus, this bill would allow tax credits to be realized by taxpayers that did not incur the actual out-of-pocket expense on which the tax credits are based, thereby providing a benefit to one taxpayer for the action of another taxpayer.

Further, this bill essentially would create a system of "tax benefit transfers" similar to the old federal safe harbor leasing regime. Tax benefits transferable under federal safe harbor leasing rules were limited to tax credits and related deductions for the purchase of certain property, and the transfer was accomplished by a nominal sale-leaseback of that property in which the rights of the parties to the various tax benefits were clearly defined. Moreover, under the old federal safe harbor leasing rules, the federal tax treatment of the various forms of consideration flowing between the parties to the transaction were clearly defined.

Unlike the old federal safe harbor leasing regime, however, the transfer, sale, or assignment of the credit under this bill would not be limited to credits related to the purchase of the low-income housing property; instead the credits could be transferred, sold, or assigned to anyone. Further, this bill is silent on the tax treatment of the various forms of consideration that may flow between the parties to the transfer, sale, or assignment transaction. Thus, absent further legislative clarification, it is unclear how the payments made by the acquiring taxpayer would be treated for California tax purposes by both the seller/transferor and the purchaser/transferee of these tax credits.

Implementation Considerations

Department staff has identified the following implementation considerations. These implementation considerations would make it very difficult to properly implement this bill. Additional concerns may be raised as the department continues to analyze the bill. Department staff is willing to assist the author with any necessary amendments to resolve these concerns.

1. This bill is silent with regard to the proper tax treatment by the transferor and the transferee of the amount paid for the transfer, sale, or assignment of the tax credits. It appears, because the bill does not state otherwise, that the transferor would include the amount received for the tax credit in income, and the transferee arguably could receive a business expense deduction for the purchase of the tax credit. In the absence of clarification, disputes may arise between taxpayers and the department about the proper tax treatment of the amount paid for the transfer, sale, or assignment of a tax credits under this bill.
2. This bill leaves unclear when the transferee taxpayer first could use the transferred tax credit and the amount that could be used. The federal rules, to which the state credit is conformed, allow allocation of the credit to the purchaser of the property. These rules specify that for the year of sale, the credit is allocated between the seller and purchaser based on the number of months each held the property. This bill does not specify whether these federal rules should apply to the proposed state transfer, allocation, and sale provisions. In the absence of direction, disputes may arise between taxpayers and the department about the timing of the use of transferred tax credits.

3. The bill does not address whether only the entire unused tax credit may be transferred or whether portions of the unused tax credit would be allowed to be transferred. If portions of the unused tax credit may be transferred, the bill does not address whether or how one tax credit may be divided among multiple transferees. Although the existing state law allowing assignment of any portion of the credit to affiliates does not specify precisely how the credit may be divided, that assignment is easier for the department to track since the assignment may be made only to affiliates with 100% ownership.
4. If audit results modify the low-income housing credit that has been transferred, assigned, or sold for consideration, it is unclear which taxpayer would be responsible for the additional tax from the audit adjustment. The bill should clarify how adjustments to the amount of the credit would be handled by the department after the credit is transferred, sold, or assigned. Moreover, since the department's audit of the transferor taxpayer's return may occur after normal expiration of the statute of limitations (i.e., under a waiver), it may be necessary for the department to request a waiver of the unaffiliated transferee taxpayer's statute of limitations. This would allow the department to adjust the transferee's tax liability if the department determines that part or all of the claimed tax benefit should be disallowed.

Alternatively, if the claimed tax credit of the transferor is disallowed only in part, it is unclear how this disallowance would be allocated between the transferor and the transferee, especially if the statute of limitations has expired for one, but not both, of the affected taxpayers.

Furthermore, if the author's intent is to allow a portion of the unused credit to be transferred, then it is unclear how a disallowance of a portion of the credit should be allocated between the taxpayers.

Technical Considerations

This bill uses incorrect terminology to refer to the federal low-income housing credit. Amendments 1 and 2 would correct the terminology.

FISCAL IMPACT

Departmental Costs

If the bill is amended to resolve the policy and implementation considerations addressed in this analysis, the department's costs are not expected to be significant.

Tax Revenue Estimate

It is not possible to project in advance the response of taxpayers to this bill if enacted.

Revenue effects would include both cash-flow acceleration of tax credit usage and absolute revenue losses. The former would reflect more immediate use of tax credits by transferees, buyers, and assignees rather than later by transferors, sellers, and assignors. The latter would reflect the fact that some transferors, sellers, and assignors never would use all the potential tax benefits.

The following data was compiled from departmental records and information from the California Tax Allocation Committee.

- ⌚ According to tax return data for 1997, approximately \$15 million in low-income housing credits were reported unused.
- ⌚ Since many credits are allocated in advance of project completion and would most likely not be claimed for tax purposes until the second and third year after the credit is allocated by the Committee, it is difficult to determine the potential stock of unused credits.
- ⌚ It is likely that some taxpayers with losses do not file the low-income housing credit form since they could not use the credit. Thus, it is likely that the stock of unused low-income housing credits is significantly larger than the above amount.

BOARD POSITION

Pending.

Analyst	Jeani Brent
Telephone #	845-3410
Attorney	Patrick Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1903
As Amended March 16, 2000

AMENDMENT 1

On page 13, line 6, after "low-income" insert:

housing

AMENDMENT 2

On page 23, line 20, after "low-income" insert:

housing